Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Why Securities Lawyers Are The New Employment Lawyers

By **Christopher Regan, Thomas Sporkin and Matthew Newman**
November 15, 2017, 5:08 PM EST

Christopher Regan

Thomas Sporkin

Matthew Newman

In early 2018, corporate America will be waiting with bated breath as the U.S. Supreme Court decides a game-changing whistleblower retaliation case.[1] For employees thinking about blowing the whistle on financial malfeasance, this decision will resolve a circuit split and clarify when protections arise: Is it enough to report concerns to a supervisor, or is U.S. Securities and Exchange Commission reporting required? Either way, the decision will fundamentally alter the relationship between companies and potential whistleblowers nationwide.

The tension between companies and whistleblowers has been fomenting for some time. When the SEC filed a whistleblower retaliation case against a public company in December 2016 for firing an employee who questioned an internal accounting policy,[2] and, just two months later, a federal jury awarded the fired general counsel of another public company nearly $11 million for raising concerns about potential Foreign Corrupt Practices Act violations,[3] corporate America was put on notice: retaliation against an internal whistleblower is not just an employment matter, it's now a significant federal securities matter as well.

In this brave new world, securities lawyers are the new employment lawyers. After the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010, employment law has been federalized and squarely injected into the securities and white collar spaces. Employers are now potentially on the hook whenever they fire, demote, threaten or otherwise retaliate against employees who are federally protected "whistleblowers" — e.g., those who report alleged securities law violations to the SEC under Dodd-Frank, or alleged securities law violations, mail fraud, wire fraud, bank fraud or certain other illicit acts to a supervisor under SOX.[4]

These retaliation claims can quickly result in high-dollar payouts, both to whistleblowers and the SEC. As described below, enhanced federal remedies and supplemental state law claims are forcing companies to redress victimized employees like never before — double back pay, attorneys' fees and punitive damages that can inflate the total dollar amount by several multiples are all possible. What's more, the SEC is now actively policing retaliation and fining companies under Dodd-Frank, regardless of the whistleblower's own assertion of rights.[5]

Employers are right to be concerned in this environment. Since the underlying allegations of financial malfeasance are often intertwined with allegations about the company's treatment of the whistleblower, battles over retaliation claims touch on a range of sensitive issues, including who controls the flow and public dissemination of scandalous information, what obligations the would-be claimant owes his employer (or former employer), whether there are limits on potentially massive damages and fines, and how to satisfy an SEC that's chomping at the bit — even under the Trump administration — to protect the whistleblowers who make its law enforcement job easier and more cost-efficient. It also means that many traditional employment law defenses have been thrown out the window.

This is a complex, evolving landscape with split courts, gray areas and major reputational stakes for everyone involved — not to mention high-pressure public disclosure obligations for the company. Below, we go down the rabbit hole and explore just a few of the sensitive, unresolved areas that should cause all stakeholders to consider whether their typical wage and hour, sexual harassment employment lawyer is equipped to handle these sophisticated securities cases.

Considerations

1. When do employees sacrifice protections by whistleblowing to their boss, but not the SEC?

Not all whistleblowers are created equal. SOX protects employees who report externally (e.g., to "a Federal regulatory or law enforcement agency") as well as internally (e.g., to "a person with supervisory authority over the employee" or to any "other person working for the employer who has the authority to investigate, discover, or terminate misconduct").[6]

On the other hand, Dodd-Frank's protections vary geographically for purely internal reporters — they currently have more rights if their claim can ultimately be filed in, say, New York or San Francisco, rather than Houston. Specifically, Dodd-Frank protects "whistleblowers" from retaliation.[7] While Dodd-Frank narrowly defines a "whistleblower" as an employee who reports suspected malfeasance "to the [SEC],"[8] an SEC rule provides a broader definition that also protects employees who report internally pursuant to SOX.[9] The issue: Should courts defer to the SEC rule and find that internal reporting alone triggers Dodd-Frank protections? Given the divergent opinions from courts nationwide,[10] the Supreme Court agreed in June 2017 to take up the issue and provide some clarity.[11] Companies should be careful what they wish for though; a victory for the employer may incentivize savvy whistleblowers to alert the SEC of suspected malfeasance before their own supervisors.

What's certain at the moment: the SEC is routinely inserting itself into private litigation — and bringing its own retaliation enforcement actions — to support protections for purely internal whistleblowers.[12]

2. Can a company enforce a confidentiality agreement even if it raises the SEC's ire?

Many employees sign boilerplate agreements with strict requirements to keep company information confidential. However, an SEC rule prohibits employers from doing anything to "impede" an individual from whistleblowing to the SEC.[13] The emblematic example of a violation: confidentiality provisions that chill whistleblowing, either by requiring the company's signoff prior to reporting, or by compelling the waiver of any eventual whistleblower awards. Since April 2015, the SEC has levied fines for these violations in well-publicized actions against at least seven companies. In January 2017, the SEC announced two additional fines.[14]

Nevertheless, even if the confidentiality agreement violates SEC rules, it isn't necessarily invalidated. So when a retaliation claim airs information covered by the agreement, the employee might be sued for breach of contract. The employee would then have to convince the tribunal that the agreement is unenforceable on grounds of public policy.[15]

3. When can an employee secretly take company documents and use them to prove retaliation?

Relatedly, despite signing agreements that prevent the public dissemination of company documents, employees will often engage in "self-help discovery" by taking or copying documents to prove their retaliation claims. They too risk exposure for breach of contract, misappropriation, sanctions,[16] or worse, but many courts have found this to be a protected activity, so long as the employee's actions were "reasonable."[17]

The "reasonableness" determination is fact-specific and depends on a range of factors, including: "(1) how the documents were obtained, (2) to whom the documents were produced, (3) the content of the documents, both in terms of the need to keep the information confidential and its relevance to the employee's claim of unlawful conduct, (4) why the documents were produced, including whether the production was in direct response to a discovery request, (5) the scope of the employer's privacy policy, and (6) the ability of the employee to preserve the evidence in a manner that does not violate the employer's privacy policy."[18] So while it might be unreasonable for an employee to indiscriminately haul out company filing cabinets to fish for incriminating information, it's a closer call when an employee conducts a tailored search, copies relevant documents, and then holds them close to the vest outside of the retaliation proceedings.

4. … Wait, but what if the whistleblower is an in-house lawyer?

While in-house counsel (and their internal audit and compliance brethren) have to jump through more hoops to recover SEC whistleblower program bounties,[19] SOX and Dodd-Frank protect them from retaliation just like any other employee.

That said, in-house counsel are bound by state ethics rules, including the duty to maintain confidences of current and former clients alike.[20] In-house counsel can divulge client confidences in limited circumstances,[21] but these exceptions vary by state and are not clear-cut — an attorney who impermissibly supports his retaliation claims with confidential information can see that information barred from the case, and then be slapped with a professional censure or disbarment to boot. While SEC ethics rules purport to allow any "attorney appearing and practicing before the [SEC]" to reveal client confidences in limited circumstances,[22] they don't necessarily preempt the state ethics rules, which may be more demanding.[23]

These dynamics recently came to a head in Wadler v. Bio-Rad Laboratories Inc., a landmark decision recognizing that an in-house lawyer had wide latitude to introduce client confidences in a SOX and Dodd-Frank retaliation trial against his former employer/client.[24] The court held that the employer's last-minute motion to exclude confidential information from trial was untimely, but found that even if it was timely: (1) the in-house lawyer may use any privileged or confidential information that is "reasonably necessary" to establish a claim or defense in the case; (2) as to a broad range of topics, the employer waived attorney-client privilege through public filings in the case and separate disclosures to the SEC, the U.S. Department of Justice, and the U.S. Department of Labor; and (3) the SEC ethics rule cited above preempts the California ethics rules to the extent the California rules are more

demanding.[25]

5. Are "binding" arbitration agreements really so binding?

Employers generally prefer that retaliation claims proceed in arbitration, behind closed doors in front of a likely more sympathetic tribunal. For SOX claims, "binding" arbitration agreements that purport to waive the right to a trial in court are simply unenforceable.[26] For Dodd-Frank claims, enforceability is less clear. Several courts have held that arbitration agreements are in fact binding on Dodd-Frank claims.[27] But the SEC's apparent position is that these claims are exempt from arbitration via Exchange Act Section 29.[28] Alternatively, where the Dodd-Frank claim is based on SOX-protected activities, some courts have read SOX's arbitration-invalidation provision into Dodd-Frank.[29]

There's a similar split for state law claims. Some courts have found that an arbitration agreement does not bar a supplemental state law claim when it's "entangled with" and "arise[s] from the same nucleus of operative facts" as a SOX claim.[30] Others have held that all state law claims, no matter how closely related to the SOX or Dodd-Frank claim, must be arbitrated if there is an arbitration agreement.[31]

6. Pumping up the payouts: Just how high can they go?

When SOX and Dodd-Frank join forces, they can provide victimized employees with sweeping, generous remedies — not only traditional "make whole" damages, but also enhanced relief like double back pay with interest, attorneys' fees, and other "special damages" like reputational harm and emotional distress.[32] Savvy whistleblowers will seek all of this, and the kitchen sink.

For instance, both laws also include a reinstatement remedy, where liable employers can be forced to reinstate a fired, demoted or suspended employee to "the same seniority status that [he] would have had" absent the retaliation.[33] What's less obvious: some terminated employees can trade reinstatement for "front pay" — cold, hard cash meant to compensate for lost future earnings.[34] This may be appropriate in several types of cases, including ones where: "(1) the parties have become inextricably mired in hostility; (2) there is no comparable position available with the plaintiff's former employer; (3) the plaintiff's former employer is no longer operating; or (4) the anticipated period of reinstatement is relatively short."[35] The takeaway: For eligible employees, front pay can significantly inflate the "make whole" damages number.[36]

Additionally, punitive damages can be awarded to punish willful or reckless actors, and make them a public example to deter future misconduct by others. Add punitives and the total payout can skyrocket several multiples beyond the "make whole" damages. But because punitive damages are not available under SOX or Dodd-Frank, employees will look to add (or sometimes shoehorn) a supplemental state law claim that can support them. In the recent Bio-Rad case described above, the jury ultimately awarded the former general counsel a whopping $10.9 million: $2.96 million in back pay — to be doubled under Dodd-Frank — plus $5 million in punitive damages via the California wrongful discharge tort.[37] The jury reportedly found the punitives appropriate because the company's CEO had apparently created and backdated a phony, negative performance review of the whistleblower.

As if that wasn't enough, the SEC is now adding fines to the mix. In September 2016, the SEC levied a $500,000 penalty against a company under the sole charge of unlawfully firing a whistleblower.[38] More often though, the SEC's retaliation claims will have to be resolved in tandem with the underlying allegations, like when a company paid $2.2 million to settle an SEC case involving both retaliation and improper trading allegations.[39]

Conclusion

Whistleblowers and their employers must resolve retaliation claims in the face of considerable uncertainty. For employers, embracing good governance is the first step to proactively reduce this uncertainty — e.g., implementing and maintaining a robust compliance and reporting system that captures internal reporting efforts, treats allegations seriously, and protects employees from retaliation in the first place.[40] Likewise, potential whistleblowers may want to consider — as early as possible — proceeding in a reasonable way that protects their rights.

But if ugly retaliation claims still rear their head, all stakeholders hoping to navigate this complex, evolving landscape would be wise to proceed cautiously, strategically, and with an eye toward the SEC. These cases inherently have a unique securities law slant — ignore at your own peril.

Christopher F. Regan and Thomas A. Sporkin are partners, and Matthew E. Newman is an associate, in the Washington, D.C., office of Buckley Sandler LLP. Prior to entering private practice, Sporkin spent more than 20 years with the SEC's Enforcement Division, where he helped launch the SEC's Whistleblower Office and write the whistleblower rules called for by the Dodd-Frank Act. Regan, a securities and white collar litigator, has handled numerous SOX and Dodd-Frank employment matters. Newman represents corporate and individual clients in a wide range of investigations, enforcement actions and litigation.

[1] See Order Granting Petition for Writ of Certiorari, Digital Realty Tr. Inc. v. Somers, 137 S. Ct. 2300 (June 26, 2017) (No. 16-1276).

[2] See SEC Press Release No. 2016-270, "Company Settles Charges in Whistleblower Retaliation Case" (Dec. 20, 2016).

[3] See Jury Verdict, Wadler v. Bio–Rad Labs. Inc., No. 15-CV-02356-JCS, ECF No. 223 (N.D. Cal. Feb. 7, 2017).

[4] See 18 U.S.C. § 1514A & 29 C.F.R. § 1980.100, et seq. (SOX claims); 15 U.S.C. § 78u-6 & 17 C.F.R. § 240.21F-1, et seq. (Dodd-Frank claims).

[5] See, e.g., SEC Press Release No. 2016-204, "SEC: Casino-Gaming Company Retaliated Against Whistleblower" (Sept. 29, 2016) (SEC's first stand-alone retaliation case).

[6] 18 U.S.C. § 1514A(a)(1).

[7] 15 U.S.C. § 78u-6(h)(1)(A).

[8] Id. § 78u-6(a)(6).

[9] See 17 C.F.R. § 240.21F-2(b)(1).

[10] Compare, e.g., Berman v. Neo@Ogilvy LLC, 801 F.3d 145 (2d Cir. 2015) (internal reporting sufficient), and Somers v. Digital Realty Tr. Inc., 850 F.3d 1045 (9th Cir.) (same), with Asadi v. G.E. Energy (USA), LLC, 720 F.3d 620 (5th Cir. 2013) (SEC reporting required).

[11] See Order Granting Petition for Writ of Certiorari, Digital Realty Tr. Inc. v. Somers, 137 S. Ct. 2300 (June 26, 2017) (No. 16-1276).

[12] See SEC, "Commission Amicus/Friend of the Court Briefs," https://www.sec.gov/litigation/amicusbriefs.shtml (briefs under "Anti-Retaliation Against Whistleblowers"); see also, e.g., supra, SEC Press Release No. 2016-270.

[13] 17 C.F.R. § 240.21F-17(a).

[14] See SEC Press Release No. 2017-14, "BlackRock Charged With Removing Whistleblower Incentives in Separation Agreements" (Jan. 17, 2017); SEC Press Release No. 2017-24, "Financial Company Charged With Improper Accounting and Impeding Whistleblowers" (Jan. 19, 2017).

[15] Compare, e.g., Erhart v. BofI Holding, Inc., No. 15-CV-02287-BAS-NLS, 2017 WL 588390, at *10 (S.D. Cal. Feb. 14, 2017) (holding, with respect to SEC reporting, that "the public policy in favor of whistleblower protection clearly outweighs the interest in the enforcement of the agreement, and the agreement is unenforceable"), with JDS Uniphase Corp. v. Jennings, 473 F. Supp. 2d 697 (E.D. Va. 2007) (holding SOX retaliation claimant was liable for breach of contract because the confidentiality agreement was enforceable).

[16] See, e.g., Order, United States ex rel. Ferris v. Afognak Native Corp., No. 3:15-cv-0150-HRH, ECF No. 328 (D. Alaska Oct. 18, 2017) (imposing $169,994 sanction on whistleblower who engaged in "abusive litigation tactics" by possessing and retaining nine privileged documents).

[17] See, e.g., Erhart, 2017 WL 588390, at *10-13; Niswander v. Cincinnati Ins. Co., 529 F.3d 714 (6th Cir. 2008); Verdrager v. Mintz Levin Cohn Ferris Glovsky & Popeo PC, 50 N.E.3d 778 (Mass. 2016).

[18] Niswander, 529 F.3d at 726.

[19] See 17 C.F.R. § 240.21F-4(b)(4).

[20] See ABA Model Rules of Professional Conduct 1.6 & 1.9.

[21] See, e.g., ABA Model Rules 1.13 & 1.6.

[22] 17 C.F.R. § 205.3.

[23] See, e.g., NYCLA Committee on Professional Ethics, Formal Op. 746: Ethical Conflicts Caused by Lawyers as Whistleblowers Under the Dodd-Frank Wall Street Reform Act of 2010 (Oct. 7, 2013).

[24] 212 F. Supp. 3d 829 (N.D. Cal. 2016), appeal filed, No. 17-16193 (9th Cir. June 8, 2017).

[25] Id. at 849, 851-53, 857.

[26] See 18 U.S.C. § 1514A(e) (as amended by Dodd-Frank in 2010).

[27] See, e.g., Khazin v. TD Ameritrade Holding Corp., 773 F.3d 488 (3d Cir. 2014).

[28] 15 U.S.C. § 78cc; see SEC Final Rule: Securities Whistleblower Incentives and Protections, 76 Fed. Reg. 34300, 34304 (June 13, 2011) ("[U]nder Section 29(a), employers may not require employees to waive or limit their anti-retaliation rights under Section 21F.").

[29] See, e.g., Wiggins v. ING U.S. Inc., No. 3:14-CV-1089, 2015 WL 3771646, at *6-7 (D. Conn. June 17, 2015).

[30] See Laubenstein v. Conair Corp., No. 5:14-CV-05227, 2014 WL 6609164 (W.D. Ark. Nov. 19, 2014); Stewart v. Doral Fin. Corp., 997 F. Supp. 2d 129 (D.P.R. 2014).

[31] See, e.g., Wiggins, 2015 WL 3771646, at *7.

[32] See 18 U.S.C. § 1514A(c) (SOX); 15 U.S.C. § 78u-6(h)(1)(C) (Dodd-Frank).

[33] Id.

[34] See, e.g., Jones v. SouthPeak Interactive Corp. of Delaware, 986 F. Supp. 2d 680 (E.D. Va. 2013) (front pay available for SOX claims).

[35] Id. at 683 (citation omitted).

[36] See, e.g., Deltek Inc. v. Dep't of Labor, Admin. Review Bd., 649 F. App'x 320 (4th Cir. 2016) (affirming SOX front pay award of four years' salary and benefits, including college tuition).

[37] See supra, Bio-RadJury Verdict; see also Stipulation for Final Judgment, Wadler v. Bio-Rad Labs. Inc., No. 15-CV-02356-JCS, ECF No. 229 (N.D. Cal. Feb. 14, 2017) (stipulating double back pay under Dodd-Frank).

[38] See supra, SEC Press Release No. 2016-204.

[39] See, e.g., SEC Press Release No. 2014-118, "SEC Charges Hedge Fund Adviser With Conducting Conflicted Transactions and Retaliating Against Whistleblower" (June 16, 2014).

[40] See generally OSHA, Recommended Practices for Anti-Retaliation Programs (Jan. 13, 2017), https://www.whistleblowers.gov/recommended_practices.html.